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No. 308

In the Supreme Court of the United States

OCTOBER TERM, 1958

AMY C. MELLOTT, PAUL C. MELLOTT AND FORREST R. MELLOTT, A MINOR, AND KAY VIRGINIA MELLOTT, A MINOR, BY THEIR GUARDIAN, THE VALLEY NATIONAL BANK OF CHAMBERSBURG, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	2
Argument	4
Conclusion	7
Appendix	8

CITATIONS

Cases:	
Anderson v. *Wilson*, 289 U. S. 20	5
Jones v. *Whittington*, 194 F. 2d 812	5
Kearney v. *United States*, 116 F. Supp. 922	5
Libson Shops, Inc. v. *Koehler*, 353 U. S. 382	4
Merchants' L. & T. Co. v. *Smietanka*, 255 U. S. 509	5
Miller v. *Jacobs*, 361 Pa. 492	7
Nagle's Estate, 305 Pa. 36	7
New Colonial Co. v. *Helvering*, 292 U. S. 435	4
Old National Bank in Evansville v. *Commissioner*, decided June 19, 1958 (C. A. 7th)	4
Patten Fine Papers v. *Commissioner*, 249 F. 2d 776	4
Sargent v. *United States*, decided April 4, 1955 (S. D. Calif.)	5
Spivak v. *Bronstein*, 367 Pa. 70	7
United States v. *Merrill*, 211 F. 2d 297	5
United States v. *Norton*, 250 F. 2d 902	5
Waterman's Estate v. *Commissioner*, 195 F. 2d 244	5

Statutes:

	Page
Internal Revenue Code of 1939:	
Sec. 23 (s) (26 U. S. C. 1952 ed., Sec. 23 (s))	4, 8
Sec. 122 (a) (26 U. S. C. 1952 ed., Sec. 122 (a))	4, 8
Sec. 122 (b) (26 U. S. C. 1952 ed., Sec. 122 (b))	4, 8
Sec. 161 (26 U. S. C. 1952 ed., Sec. 161)	4
Sec. 162 (b) (26 U. S. C. 1952 ed., Sec. 162 (b))	4, 7, 9
Sec. 170 (26 U. S. C. 1952 ed., Sec. 170)	4, 6, 10
Internal Revenue Code of 1954, Sec. 642 (h) (26 U. S. C. 1952 ed., Supp. V, Sec. 642 (h))	5, 6
Estates Act of 1947, 20 Purdon's Pennsylvania Statutes Annotated (Permanent ed., 1950), Sec. 301.8	7
Fiduciaries Act of 1949, 20 Purdon's Pennsylvania Statutes Annotated (Permanent ed., 1950), Sec. 320.504	7
Miscellaneous:	
H. Conference Rep. No. 2543, 83d Cong., 2d Sess., p. 54 (3 U. S. C. Cong. & Adm. News (1954) 5280, 5314)	6
H. Rep. No. 1337, 83d Cong., 2d Sess., p. A201 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4341)	6
S. Rep. No. 1622, 83d Cong., 2d Sess., p. 83 (3 U. S. C. Cong. & Adm. News (1954) 4621, 4715)	6
Treasury Regulations 111, Sec. 29.170–1	4, 10

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OPINIONS BELOW

The opinion of the District Court (R. 2a–6a) is reported at 156 F. Supp. 253. The opinion of the Court of Appeals (Pet. 10–22) is not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on July 2, 1958. A petition for rehearing was denied on July 21, 1958. The petition for certiorari was filed on August 26, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether under Sections 23 (a), 122 (b), and 170 of the Internal Revenue Code of 1939 the heirs of an estate, in computing their individual income taxes, may claim the benefits of a carry-back of a net operating loss sustained by the estate in the operation of its affairs.

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of Sections 23 (s), 122 (a) and (b), 162 (b), and 170 of the Internal Revenue Code of 1939, and Section 29.170–1 of Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, are set forth in the Appendix, *infra*, pp. 8–11.

STATEMENT

The facts, which are not in dispute, may be summarized as follows:

Herman B. Mellott, a road contractor and strip-coal mine operator who lived in Pennsylvania, died intestate on July 16, 1948. He was survived by his widow and three children. Under Pennsylvania law, the widow inherited one-third of the deceased's estate, and the three children inherited the remaining two-thirds in equal shares. The widow and oldest son, as administrators of the estate, continued to operate the business of the estate pending its final distribution. (Pet. 10.)

In September 1949, the administrators filed a fiduciary return on the cash basis for the period beginning July 16, 1948, the date of the decedent's

death, and ending June 30, 1949. This return reported a sizeable net income. Since the decedent died intestate, and under Pennsylvania law there was no provision for the accumulation of income of an intestate, the net income reported in the fiduciary return was currently distributable to the heirs of the estate, and they reported their distributive shares in their individual income tax returns for 1949. Accordingly, under Section 162 (b) of the Internal Revenue Code of 1939, the estate was allowed a deduction for income currently distributable to the heirs, and the estate had no taxable income for the period ending June 30, 1949. (Pet. 10–11.)

In the latter part of 1950, the administrators of the estate filed a fiduciary income tax return for the fiscal year ended June 30, 1950, in which was reported a substantial net operating loss approximating something less than 75 per cent of the estate's net income for the prior year. The administrators, however, did not amend the June 30, 1949, fiduciary income tax return of the estate to include the carry-back of the net operating loss. Instead, each of the heirs, in proportion to his or her share of the estate under the Pennsylvania Intestate Law, claimed a part of the estate's 1950 net operating loss, and each recomputed his or her 1949 individual tax return to reflect this loss. (Pet. 11–12.)

The heirs filed claims for refunds for federal income taxes paid by them individually for 1949. The Commissioner denied these claims, and the heirs brought suit. Upon motions for summary judgment

by the heirs and the United States, the District Court rendered judgment for the United States. (Pet. 12.) The Court of Appeals affirmed. (Pet. 10–22.)

ARGUMENT

The decision of the court below is correct, there are no conflicting decisions, and no question of general importance is presented.

Section 23 (s) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 8) authorizes a deduction from gross income of a net operating loss to the extent provided in Section 122 (Appendix, *infra*, pp. 8–9). By Section 170 of the 1939 Code (Appendix, *infra*, p. 10) the benefits of this deduction are allowed to an estate. See Treasury Regulations 111, Section 29.170–1 (Appendix, *infra*, pp. 10–11). Section 122 (b) (Appendix, *infra*, pp. 8–9) provides that if "the taxpayer has a net operating loss" for any taxable year, he may carry back the loss to each of the two preceding taxable years. This Court has held that a loss deduction is personal to the taxpayer and the business that sustained it, and is not transferable to another taxpayer in the absence of express statutory permission. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440–441; *Libson Shops, Inc.* v. *Koehler*, 353 U. S. 382. See also *Patten Fine Paper* v. *Commissioner*, 249 F. 2d 776, 779–780 (C. A. 7th); *Old National Bank in Evansville* v. *Commissioner* (C. A. 7th), decided June 19, 1958 (58–2 U. S. T. C., par. 9623).

The relevant 1939 Code provisions, Sections 161 (26 U. S. C., 1952 ed., Sec. 161), 162 (b) (Appendix,

infra, pp. 9–10), and 170, *supra*, treat an estate as an entity separate from its beneficiaries and confine deductions to the estate, where the estate sustained the loss. Here, taxpayers, as beneficiaries of the estate, are not the same taxpayer as the estate and are not entitled to the estate's loss carry-back. *Anderson* v. *Wilson*, 289 U. S. 20, 26–27; *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509, 516; *United States* v. *Norton*, 250 F. 2d 902, 905 (C. A. 5th); *Waterman's Estate* v. *Commissioner*, 195 F. 2d 244, 245 (C. A. 2d); *United States* v. *Merrill*, 211 F. 2d 297, 300 (C. A. 9th); *Jones* v. *Whittington*, 194 F. 2d 812, 817 (C. A. 10th); *Kearney* v. *United States*, 116 F. Supp. 922, 925–926 (S. D. N. Y.); *Sargent* v. *United States* (S. D. Calif.), decided April 4, 1955 (1955–1 U. S. T. C., par. 9424).

Certainly, contrary to taxpayers' contention (Pet. 6–7), Section 642 (h) of the Internal Revenue Code of 1954[1] affords taxpayers no assistance. The 1954

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[1] SEC. 642. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.

* * * * * * *

(h) *Unused Loss Carryovers And Excess Deductions On Termination Available To Beneficiaries.*—If on the termination of an estate or trust, the estate or trust has—

(1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or

(2) for the last taxable year of the estate or trust deductions (other than the deductions allowed under subsections (b) or (c)) in excess of gross income for such year,

then such carryover or such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary or his delegate, to the beneficiaries succeeding to the property of the estate or trust.

* * * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 642.)

Code section permits beneficiaries upon termination of an estate to use as a deduction on their individual returns an unused net operating loss carry-over. But here the estate had not terminated and the net operating loss is sought to be carried back to an earlier year. Moreover, the 1954 Code does not govern the taxable years at bar. Indeed, as both courts below recognize (R. 6a; Pet. 19), the legislative history of Section 642 (h) sustains their holdings, since it makes clear that Congress proposed to leave unchanged the acknowledged prior law, under which losses incurred by an estate or trust are not deductible by its beneficiaries. H. Rep. No. 1337, 83d Cong., 2d Sess., p. A201 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4341); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 83 (3 U. S. C. Cong. & Adm. News (1954) 4621, 4715); H. Conference Rep. No. 2543, 83d Cong., 2d Sess., p. 54 (3 U. S. C. Cong. & Adm. News (1954) 5280, 5314). Additionally, the legislative history of the net operating loss provisions and of Section 170 of the 1939 Code set forth in the opinions of both courts below (R. 5a–6a; Pet. 19) strongly supports their holdings.

Nor is there any merit to taxpayers' contention (Pet. 7–8) that the income of the estate has not been correctly computed and therefore the income "imputed" (Pet. 8) to the heirs is not correct. Under applicable Pennsylvania law, there was no provision for the accumulation of income of an intestate, and the net income reported in the fiduciary return for the year ending June 30, 1949, was currently distributable

to the heirs of the estate. (R. 3a; Pet. 11, 21–22.)[2] Thus, this income was required to be included in computing the income of the heirs. See Section 162 (b), *infra*, pp. 9–10.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1958.

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[2] Under Pennsylvania law, personal representatives may not carry on the business of a decedent unless authorized by will or by state court, and the entire income of the estate was distributable to the beneficiaries. Fiduciaries Act of 1949, 20 Purdon's Pennsylvania Statutes Annotated (Permanent ed., 1950), Section 320.504; Estates Act of 1947, 20 Purdon's Pennsylvania Statutes Annotated, *supra*, Section 301.8; *Spivak* v. *Bronstein*, 367 Pa. 70, 75; *Miller* v. *Jacobs*, 361 Pa. 492; *Nagle's Estate*, 305 Pa. 36, 39.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(s) [as added by Sec. 211 (a), Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 122 [as added by Sec. 211 (b), Revenue Act of 1939, *supra,* and amended by Sec. 105 (e) (3) (A), Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 215 (a), Revenue Act of 1950, c. 994, 64 Stat. 906]. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—

(A) *Loss for Taxable Year Beginning Before 1950.*—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of

such net operating loss over the net income for the second preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

(B) *Loss for Taxable Year Beginning After 1949.*—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

* * * * *

(26 U. S. C. 1952 ed., Sec. 122.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(b) [as amended by Sec. 111 (b), Revenue Act of 1942, *supra*] There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries, whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the

taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

* * * * *

(26 U. S. C. 1952 ed., Sec. 162.)

SEC. 170 [as added by Sec. 211 (c), Revenue Act of 1939, *supra*]. NET OPERATING LOSSES.

The benefit of the deduction for net operating losses allowed by section 23(s) shall be allowed to estates and trusts under regulations prescribed by the Commissioner with the approval of the Secretary. The benefit of such deduction shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Commissioner with the approval of the Secretary.

(26 U. S. C. 1952 ed., Sec. 170.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.170–1. *Net Operating Loss Deduction in the Case of Estates, Trusts, and Common Trust Funds.*—(a) *Estates and Trusts.*—The net operating loss deduction allowed by section 23(s), computed as provided by section 122, shall be available to estates and trusts generally, with the following exceptions and limitations:

(1) A net operating loss for a year for which a trust was exempt from tax under section 165 may not be used in the computation of the net operating loss carry-over.

(2) In computing gross income and deductions for the purposes of section 122, a trust shall exclude that portion of the income and deductions attributable to the grantor under section 166 and section 29.166–1(c).

(3) An estate or trust shall not, for the purpose of section 122, avail itself of the deductions allowed by section 162.

(b) *Common trust funds.*—The net operating loss deduction is not allowed to a common trust fund. Each participant in a common trust fund, however, will be allowed the benefits of such deduction. In the computation of such deduction a participant in a common trust fund shall take into account its pro rata share of the income and losses of the common trust fund as prescribed by section 29.189–1 in the case of partners.

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